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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

THE WHARF (HOLDINGS) LIMITED, a Hong Kong company; WHARF COMMUNICATIONS INVESTMENTS LIMITED, a Hong Kong company; and STEPHEN NG, a Hong Kong citizen,

Petitioners,

v.

UNITED INTERNATIONAL HOLDINGS, INC., a Delaware corporation; and UIH ASIA INVESTMENT CO., a Colorado general partnership,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR PETITIONERS

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QUESTIONS PRESENTED FOR REVIEW

By Order filed November 6, 2000, this Court granted certiorari in respect of the following questions:

1. Whether the Court of Appeals erred in holding that Section 10(b) of the Securities and Exchange Act of 1934 and S.E.C. Rule 10b-5 apply to disputes over the ownership of securities where there is no claim that financial information was misrepresented or not disclosed?

2. Whether the Court of Appeals erred in holding that Section 10(b) and Rule 10b-5 apply where plaintiffs' only claim seeks damages for nonperformance of an alleged unenforceable oral option?

PARTIES TO THE PROCEEDING AND CORPORATE DISCLOSURE STATEMENT IN ACCORDANCE WITH RULE 29.6 OF THE RULES OF THE SUPREME COURT OF THE UNITED STATES

The petitioners are The Wharf (Holdings) Limited, a Hong Kong company, Wharf Communications Investments Limited, a Hong Kong company, and Stephen Ng, a Hong Kong citizen, who were defendants-appellants below and shall be referred to as "petitioners", "defendants", or "Wharf" throughout this brief. Wharf Communications Investments Limited is wholly owned by The Wharf (Holdings) Limited. More than 10% of the stock in The Wharf (Holdings) Limited is owned by Wheelock & Co. Limited, a Hong Kong company.

The respondents are United International Holdings, Inc., a Delaware corporation, and UIH Asia Investment Company, a Colorado general partnership based in Hong Kong, who were plaintiffs-appellees below and shall be referred to as "respondents", "plaintiffs", or "UIH" throughout this brief.

The corporate disclosure statement at p. ii of Petitioners' Petition for Writ of Certiorari dated September 5, 2000 is still accurate.

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THE WHARF (HOLDINGS) LIMITED, a Hong Kong company; WHARF COMMUNICATIONS INVESTMENTS LIMITED, a Hong Kong company; and STEPHEN NG, a Hong Kong citizen,

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BRIEF FOR PETITIONERS

OPINIONS BELOW

The Opinion of the Court of Appeals is reported at 210 F.3d 1207 (10th Cir. 2000) and annexed to the Petition for Writ of Certiorari as Appendix B. (P. App. B.)[1] This Decision

[1] Citations to the Appendix to the Petition for Writ of Certiorari are denoted "P. App. __"; citations to the Joint Appendix are denoted "J. App. __"; citations to the Lodging to the Joint Appendix are denoted "L.J.A. __"; citations to the Appellants' Appendix filed with the U.S. Court of Appeals for the Tenth Circuit are denoted "Aplt. App. __"; citations to the Appellants' Addendum of Trial Exhibits filed with the U.S. Court of Appeals for the Tenth Circuit are denoted "Add. __".

affirmed the Judgment of the United States District Court for the District of Colorado filed on May 22, 1997, the Order of October 23, 1997, confirming the Order/Recommendation of September 25, 1997 of United States Magistrate Judge Bruce D. Pringle, and the Order of the Court dated October 23, 1997, denying Defendants' motion pursuant to Fed. R. Civ. P. 50 and 59 and Colo. Rev. Stat. § 13-21-102. These final orders and judgments of the District Court are not officially reported but are annexed to the Petition for Writ of Certiorari as Appendices C, D and E. (P. App. C; D; E.)

JURISDICTION

The judgment of the United States Court of Appeals for the Tenth Circuit was entered on April 28, 2000. Petitioners' petition to the Court of Appeals for the Tenth Circuit for rehearing with suggestion for rehearing en banc was denied on June 8, 2000; that order is annexed to the Petition for Writ of Certiorari as Appendix F. (P. App. F.)

Petitioners filed a petition for writ of certiorari on September 5, 2000. This Court granted certiorari as to Questions 1 and 2 presented by the petition on November 6, 2000; that order is annexed hereto as Appendix ET. (J. App. ET.)

The jurisdiction of this Court rests upon 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), and S.E.C. Rule 10b-5, 17 C.F.R. § 240.10b-5. These provisions are set out in Appendices G and H to the Petition for Writ of Certiorari. (P. App. G; H.)

STATEMENT OF THE CASE

Nature of the Case

Respondent United International Holdings, Inc.'s ("UIH") claim is a breach of contract claim masquerading as a violation of the federal securities laws. UIH's sole claim is that petitioner, The Wharf (Holdings) Limited ("Wharf"), refused to perform its obligations under an alleged oral agreement giving UIH an option to purchase 10% of the stock in the Hong Kong cable TV system which Wharf was organizing ("Wharf Cable"). UIH asserts that Wharf's refusal to perform this alleged contractual obligation was a breach of contract, common law fraud and a violation of Section 10(b) of the Securities and Exchange Act of 1934 ("Section 10(b)"), 15 U.S.C. § 78j(b), and S.E.C. Rule 10b-5 ("Rule 10b-5"), 17 C.F.R. § 240.10b-5. Stated simply, UIH's lawsuit is nothing more than a dispute between two private parties over the ownership of securities — a matter which the Circuit Courts have consistently regarded as governed by state law.

UIH did not purchase the stock of Wharf Cable or any other security; UIH's complaint is rather that Wharf refused to sell it the stock of Wharf Cable. UIH's alleged right to purchase the stock of Wharf Cable is based solely on oral evidence of the kind which this Court has rejected as an evidentiary basis for proving the purchase of a security. UIH, therefore, has no standing to assert a claim under Section 10(b) or Rule 10b-5.

UIH's claim has no relation to the integrity of the public or private securities markets. UIH does not claim that Wharf made any financial misrepresentation or any misrepresentation going to the value of a securities purchase. UIH's common law breach of contract and tort claims have historically been governed by state law. There is no reason at this late date for this Court to expand the private cause of action judicially implied under Section 10(b) to federalize matters which have traditionally been governed by state law.

Statement of Facts

1. Introduction.

Petitioner The Wharf (Holdings) Limited, is a long-established Hong Kong company, with significant holdings in transportation, communications and real estate. Wharf owns and operates the cable TV system in Hong Kong through its subsidiaries, Wharf Communications Investments Limited ("WCIL"), Cable Network Communications Limited ("CNCL") and Wharf Cable Limited ("Wharf Cable"). (Petitioner The Wharf (Holdings) Limited and its subsidiaries are hereinafter referred to as "Wharf").[2] Petitioner Stephen Ng is an officer of Wharf.

Respondent United International Holdings, Inc. ("UIH") is a Denver-based cable TV consulting and investment company. Respondent UIH Asia Investment Co. ("UIH Asia") is a partnership between UIH and two Hong Kong corporations through which UIH sought to invest in Wharf Cable. (J. App. E-1-2; F-3.)

Wharf Cable was awarded a franchise to install and operate the Hong Kong cable TV system on June 1, 1993 and launched operations of the system on October 31, 1993. During the latter part of 1992 and the first half of 1993, Wharf had extended discussions with NYNEX Corp. (the New York/New England Telephone Company) and Respondent UIH concerning possible investments in Wharf Cable.[3] Those discussions did not result in any agreement and Wharf Cable commenced operations as a wholly-owned indirect subsidiary of The Wharf (Holdings)

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[2] Wharf Cable was originally a defendant, but is not an appellant because all claims against it have been withdrawn or dismissed.

[3] CNCL, a Wharf subsidiary and the direct parent of Wharf Cable, is the company in which UIH and NYNEX would have purchased shares if the parties had reached an agreement. For simplicity, the term "Wharf Cable" is used herein to refer both to the entity in which UIH sought to invest and the entity operating the Hong Kong cable TV system.

Limited in October 1993. In 1994, Respondent UIH filed suit against Wharf in the United States District Court for the District of Colorado, claiming for the first time that representatives of Wharf and UIH had entered into an oral agreement during a conversation on October 8, 1992, pursuant to which Wharf granted UIH an option to purchase 10% of Wharf Cable for $50,000,000+/-. That alleged oral option agreement was never put in writing or referred to in any contemporaneous document.

UIH's allegations are inconsistent with the entire documentary history of the parties' negotiations, which conclusively proved that the parties intended to proceed from expressly nonbinding letters of intent to a legally binding stock purchase agreement — not an oral option agreement. Neither the letters of intent nor the stock purchase agreement were ever agreed to or executed. UIH's lawsuit claimed that Wharf's refusal to perform the alleged oral option was a breach of contract and common law fraud. In order to justify federal subject matter jurisdiction, UIH decided to attempt to plead these alleged state-law claims as a violation of Section 10(b) and Rule 10b-5.

2. Wharf, NYNEX and UIH discuss possible investments in Wharf Cable by NYNEX and UIH between August and November 1992.

In May 1992, Wharf learned that the Hong Kong government would seek bids for a cable TV franchise in September 1992. During June 1992, Wharf met with NYNEX and UIH to discuss their possible participation in the project. (P. App. Z-2-3; AB-1-3; AJ-1-2; AK-1.) Those discussions focused on the drafting of two documents: a letter of intent and a shareholders' agreement. In those discussions, Wharf, NYNEX and UIH were careful to define the point at which negotiations would mature into legally binding obligations.

All three parties understood that those legal obligations would arise only after they had agreed on the many issues

involved in such a project, their boards of directors had approved the project, their complex agreement was set forth in a written shareholders' agreement and the shareholders' agreement was executed by authorized executives of the parties. (Aplt. App. 2944-47, 2952-54.) In a memo at the outset of the negotiations dated June 4, 1992, UIH's president, Mr. Mark Schneider, wrote that, "***there will be ways out of the deal depending on approval, etc.***" (L.J.A. M-1) (emphasis added). Mr. Schneider's June 4, 1992 memo anticipated "a term sheet to be drafted next week". (L.J.A. M-1.) That term sheet, prepared on June 11, 1992, by UIH's chief negotiator, Mr. Michael Fries, set forth the following "***Conditions Precedent***":

> Approval of financial and operating plan.
> ***Board consent.***
> Receipt of CATV license.
> Government/regulatory approvals.
> ***Final documentation.***

(L.J.A. O-3; *see* J. App. BZ-6-7; DN-10-11) (emphasis added).

On August 24, 1992, UIH's Hong Kong counsel, Ms. Sonjia Norman, wrote to one of Wharf's negotiators, Mr. Emil Fung, commenting on the initial draft of a letter of intent. (L.J.A. W-1-4; J. App. BX-1-5; DL-1-7.) That memorandum stated:

> Our signing of the full Shareholder's Agreement after this letter of intent ***should be conditional*** upon:
>
> a) our approval of the financial, operating and programming plans;
>
> b) ***board consent on both sides;***
>
> c) award of the local franchise;
>
> d) the subscription by NYNEX of 20% of Wharf Cable.

(L.J.A. W-1) (emphasis added).

These documents prove that UIH understood that board consent was required and that the parties' legal obligations were to be set forth in a definitive written shareholders' agreement that would be executed by the parties. Wharf and UIH never completed or signed any of the draft letters of intent or draft shareholders' agreements under negotiation during 1992.

Counsel for Wharf drafted the first of a series of expressly nonbinding letters of intent in August 1992. The letter of intent was to be followed by a binding shareholders' agreement. The letter of intent expressly stated that:

> ***This letter does not create legally binding and enforceable obligations*** . . . . Each of the parties will negotiate in good faith, and use all reasonable endeavours to conclude the terms of a formal, ***legally binding shareholders' agreement*** between them . . . .

(L.J.A. V-2, 5-6) (emphasis added).

The draft letter also stated that any agreement was "***subject to each of them obtaining all requisite consents and authorities*** including, where necessary, approvals of shareholders and their boards of directors to the proposed investment . . . ." (L.J.A. V-2) (emphasis added).

All of the draft letters of intent provided that Wharf, NYNEX and UIH would acquire stock representing 70% (Wharf), 20% (NYNEX) and 10% (UIH) of the cable TV project, respectively, and stated that the three parties "***will subscribe for shares*** and make loans to Wharf Cable pro-rata to their ownership interests". (L.J.A. V-3; *see* L.J.A. Y-4; Z-3; AD-4; AJ-4) (emphasis added). The draft letters of intent, therefore, made it plain that Wharf, NYNEX and UIH contemplated a shareholders' agreement which would ***obligate*** each of them to contribute its aliquot share of the capital of the cable TV project. UIH's ***obligation*** to buy 10% of the stock of Wharf Cable contemplated by the draft letters of intent is flatly

inconsistent with UIH's later oral option claim, which would have left any investment by UIH at its discretion.

Wharf, NYNEX and UIH discussed the draft letters of intent during August and September 1992, circulating at least five drafts. (L.J.A. V; Y; Z; AD; AJ; P. App. AO-1-2; AP-1-2; AQ-1-2.) Throughout those revisions, each of the drafts provided that:

(1) the letters did not create legally binding obligations;

(2) the parties were to negotiate and execute legally binding written shareholders' agreements;

(3) the transaction was subject to approval by their boards of directors; and

(4) the letters of intent provided for obligations on the part of Wharf, NYNEX and UIH to purchase their respective shares of the stock of Wharf Cable.

3. Wharf, NYNEX and UIH fail to reach agreement as to the draft letters of intent or draft shareholders' agreements.

Wharf, NYNEX and UIH were unable to agree upon the letter of intent by the September 30, 1992 deadline for submission of franchise bids to the Hong Kong government. (Aplt. App. 2546-47, 2695-96, 4156-57, 5868-69, 7108-10.) As a result, Wharf submitted the bid in its own name. The Wharf bid expressly stated that:

> If Wharf Cable is successful in its licence application, ***Wharf will consider the introduction at the appropriate time of NYNEX, UIH and other strategic partners as co-investors*** to purchase up to 40% of the shares in CNCL.

(L.J.A. AY-6) (emphasis added).

Wharf, NYNEX and UIH began negotiating the draft shareholders' agreement in September 1992. (J. App. BU-6; Aplt. App. 7961-62.) That document, which was more than

fifty pages in length, had complex provisions relating to the parties' ownership, their financing obligations, governance, sale of their interests, dividends and the like. (L.J.A. BL.) As a result of the complexity of the agreement, negotiations continued into November. (P. App. AC-2-4; AD-1-2; AR-1, 5; L.J.A. BO-3-4.) A memo by the chief negotiator for UIH, Mr. Michael Fries, dated November 9, 1992, summarized his recent trip to Hong Kong and identified outstanding issues which had not been resolved. (L.J.A. BO.) First on Mr. Fries' list of ***"Key issues" for negotiation was the issue of "ownership"***. (L.J.A. BO-4) (emphasis added).

The draft shareholders' agreement went through four revisions in the Fall of 1992, which were dated September 16, October 26, November 4 and November 19, 1992. (P. App. AM-1; L.J.A. BL-1; BN-1; BR-1.) All of those revisions imposed obligations on the shareholders to fund the cable system in proportion to their stock ownership. (L.J.A. AG-19-26; BL-16-22; BN-16-22; BR-16-22.) All versions of the draft agreement contained ***integration clauses*** which rendered void any oral agreement relating to its subject matter. (L.J.A. AG-52; BL-48; BN-49; BR-49.) The successive drafts of agreement were, therefore, uniformly inconsistent with UIH's later alleged oral option, in all their versions — both before and after October 8, 1992, the date on which UIH's witnesses claimed they entered into an oral option agreement. (J. App. O-1-2; AD-1-3; AH-2; AX-1-2.)

Toward the end of 1992, NYNEX notified Wharf that it was not prepared to proceed with its proposed investment in the Hong Kong cable TV project. (J. App. DU-2; L.J.A. BX-1; BY-1.) Mr. Ng, an officer of Wharf, promptly told Mr. Schneider, the President of UIH, about the NYNEX change of position. More importantly, Mr. Ng also told Mr. Schneider that Wharf had decided to postpone any decision about investments by UIH until after the Hong Kong cable TV service was launched in October 1993. (L.J.A. BY-1.) Mr. Ng confirmed that advice in a letter to Mr. Schneider dated

February 27, 1993: "I mentioned to you in London that, given the NYNEX situation, ***we should put ownership issues on hold until after service launch***." (L.J.A. CF-1) (emphasis added). The franchise was awarded to Wharf on June 1, 1993, and Wharf launched the cable TV service on October 31, 1993. (P. App. Y-2; AA-2.)

4. UIH attempts to reopen negotiations during 1993.

As of April 30, 1993, Wharf and UIH had reached no agreement relating to UIH's ownership of Wharf Cable stock. UIH knew that. It was the absence of any agreement that prompted UIH's Mr. Fries to send a newly drafted Memorandum of Understanding ("MOU") relating to UIH's proposed investment to Mr. Emil Fung of Wharf on April 30. (L.J.A. CI.) Neither Mr. Fries' letter transmitting the MOU nor the draft MOU made any reference to the alleged oral option agreement of October 8, 1992. (L.J.A. CI-1-9.) To the contrary, Mr. Fries' letter said: "We left the issue of UIH's ownership in Stephen's [Mr. Ng's] hands." (L.J.A. CI-1.)

Unlike the 1992 draft letters of intent, Mr. Fries' draft MOU purported to be legally binding: "This Agreement is legally binding upon both parties . . . . " (L.J.A. CI-9.) Despite its ostensibly enforceable nature, the MOU stated that UIH's acquisition of the shares in CNCL[4] was "conditioned upon . . . . approval by both UIH and Wharf of . . . the Pay TV Business Plan", and "the Shareholders' Agreement". (L.J.A. CI-4.)

Like the earlier draft letters of intent, Mr. Fries' draft MOU referred to an obligation of UIH to acquire the shares of Wharf Cable. The draft MOU "records the principle [sic] terms and conditions pursuant to which the parties will cooperate together and invest in . . . . [CNCL]": "UIH ***shall*** acquire up to 20% of the shares of CNCL from Wharf"; and "[o]n the Acquisition

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[4] CNCL is the Wharf subsidiary in which UIH would have purchased stock and which owned the stock of Wharf Cable. The term "Wharf Cable" is used herein to refer to CNCL and to its subsidiary, Wharf Cable.

Date, UIH ***will*** make an initial capital contribution . . . ." (L.J.A. CI-3, 4) (emphasis added).

Although Mr. Fries' April 30 draft MOU purported to be a legally binding agreement, it made any obligation conditional on future approval by Wharf and UIH. (L.J.A. CI-4.) Subsequent draft MOUs prepared by UIH in June and July of 1993 did apparently contemplate some form of option, but that concept was abandoned when UIH submitted its last MOU in November 1993 which once again obligated UIH to purchase stock in Wharf Cable. (*Compare* Add. 409, 418, 430, *with* L.J.A. DC-4-6.)

Although UIH persisted in its efforts to acquire stock in Wharf Cable through 1993, UIH never sent Wharf any communication claiming that Wharf had entered into an oral option agreement on October 8, 1992, or demanding its performance. To the contrary, UIH's communications repeatedly admitted the absence of any obligation. On November 5, 1993, Mr. Schneider wrote to Mr. Ng, saying "UIH has an ***expectation and desire*** to invest not less than 10% in the Wharf Cable project". (L.J.A. DC-1) (emphasis added). That letter carried with it UIH's last draft MOU. (L.J.A. DC-4-10.) As Mr. Schneider described the MOU: "The contract establishes the basic terms of UIH's investment and confirms our good faith negotiations ***but would be subject to both of our board's approval.***" (L.J.A. DC-1) (emphasis added).

The November 5, 1993 draft MOU stated that "[o]n or before . . . the 'Acquisition Date' . . . UIH ***will*** acquire a [10%] ownership interest in CNCL" and that "[e]ach shareholder ***shall*** fund its pro rata share of Capital Contributions . . . ." (L.J.A. DC-4, 5) (emphasis added). That is, this draft MOU, like the earlier draft letters of intent and draft shareholders' agreements, obligated UIH to purchase shares in Wharf Cable. It did not create an option. (Aplt. App. 6751-53.) And even at that late stage, UIH's proposed MOU remained conditional. UIH's last draft MOU still required the approval of both boards of

directors: "UIH's investment in CNCL is conditioned upon the approval of the board of UIH and WCIL." (L.J.A. DC-4.)

5. UIH's oral option claim.

UIH's claim in this case is based on the testimony of two of its officers that Mr. Ng orally agreed to grant UIH an option to purchase stock in Wharf Cable during a conversation on October 8, 1992. Mr. Ng has consistently denied that any such conversation took place. UIH's claim is flatly inconsistent with the documentary record of the parties' negotiations, which conclusively proves that Wharf and UIH did not intend to be bound except by the written shareholders' agreement. These documents — from the first draft letter of intent to the last MOU drafted by UIH — clearly prove that the parties understood that any agreement remained conditional upon the approval of their boards of directors. (L.J.A. O-3; V-2; Y-2; Z-1; AD-2; CI-4; DC-4.) It is undisputed that Wharf's board never approved and that the parties never agreed to or signed the draft letters of intent, MOUs or shareholders' agreements.

UIH's oral option claim is also inconsistent with the draft letters of intent and draft shareholders' agreements prepared during 1992 because all of them involved a stock purchase agreement, not an option agreement. Moreover, despite the fact that the shareholders' agreement drafts of September 16, October 26, November 4, and November 19, 1992, were contemporaneous with the alleged oral option agreement of October 8, 1992, and contained an integration clause that expressly voided all other agreements "orally or in writing", UIH never attempted to modify those inconsistent provisions. Indeed, there is not a single communication sent by UIH to Wharf in which UIH asserted that the parties had entered into an oral option agreement or demanded its performance at any time prior to the filing of this lawsuit.

6. Proceedings in District Court.

In its complaint, UIH alleged claims for violation of Section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)"), 15 U.S.C. § 78j(b), and S.E.C. Rule 10b-5 ("Rule 10b-5"), 17 C.F.R. § 240.10b-5, as well as state-law claims for breach of contract, fraud, negligent misrepresentation, breach of fiduciary duty and state securities law violations. Because the parties lacked diversity of citizenship, the District Court's subject matter jurisdiction was based solely on its "arising under" jurisdiction under 28 U.S.C. § 1331.

Wharf moved to dismiss the case at the outset on the grounds that UIH had failed to allege facts which could constitute a violation of Section 10(b) or Rule 10b-5 and that the District Court lacked subject matter jurisdiction. (J. App. D; E; G.) These motions were summarily denied and the case proceeded to trial. (J. App. A-6.) The jury found Wharf liable on all causes of action.

During the trial, UIH misrepresented its compensatory damages and misled the jury into awarding damages which are many times any injury UIH could have suffered. UIH claimed that it had expended no more than $1,000,000 in reliance expenditures designed to position itself to become a potential investor attractive to Wharf. (P. App. AY-1; J. App. F-2.) UIH, however, did not limit its damage claims to the reliance loss allegedly sustained. Rather, UIH claimed that it had been deprived of the value of an oral option to purchase 10% of the shares of Wharf Cable upon payment of 10% of the shareholder capital of Wharf Cable. In valuing an option, the exercise price must be deducted from the value of the stock purchased on exercise. *See, e.g., Hermanowski v. Acton Corp.*, 729 F.2d 921, 922 (2d Cir. 1984) (per curiam).

UIH's damage expert, Mr. Robert Jones, did not value UIH's alleged option to buy 10% of the stock of Wharf Cable for $50,000,000+/-. (P. App. AF-3-4.) He estimated the value

of 10% of the stock of Wharf Cable. He did not deduct the $50,000,000 exercise price from his valuation of 10% of the stock of Wharf Cable. (P. App. AF-3-4.) He determined that value to be $50 million as of October 1992 and $67 million as of March 1994. (J. App. EG-92-98, 104-07.) In its closing argument, UIH misrepresented Mr. Jones' study to be a valuation of UIH's option. (P. App. AI-3-4.) Despite Wharf's arguments, UIH successfully deceived the jury. In awarding compensatory damages of $67,000,000, the jury adopted the higher of Mr. Jones' two valuations of the value of 10% of the stock of Wharf Cable. (J. App. EP-4, 9, 10, 13, 18, 22, 24, 26, 31, 34.)

Since UIH had to pay $50,000,000+/- upon exercise of its alleged option, which plaintiff's expert witness disregarded, the jury's award of $67,000,000 overstated the damages allegedly sustained by UIH by about $50,000,000. The injury inflicted on Wharf was compounded by the jury's award of an additional $58,500,000 in punitive damages — an amount which was 65 times UIH's economic loss of less than $1,000,000. (*Compare* J. App. EP-5, *with* P. App. AY-1; J. App. AX-3.) Because punitive damages cannot exceed compensatory damages under Colorado law, UIH's successful misrepresentation of its compensatory damages resulted in a $100,000,000 mistake *See* Colo. Rev. Stat. § 13-21-102(1)(a).

7. Wharf's appeal to the Tenth Circuit.

Wharf sought relief from what it perceived to be a gross miscarriage of justice by appeal to the Court of Appeals for the Tenth Circuit. Wharf argued that the private cause of action implied under Section 10(b) did not apply to disputes over the ownership of securities, such as UIH's oral option claim, and that the District Court, therefore, had no jurisdiction under 28 U.S.C. § 1331.[5] The Tenth Circuit held that Section 10(b) does

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[5] One of the plaintiffs in the District Court, UIH Asia, was an affiliated partnership with Hong Kong resident partners. That meant that the

apply to disputes over the ownership of securities, in conflict with this Court's decision in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), and the decisions of the Third, Fourth, Seventh and Ninth Circuits in *Gurwara v. LyphoMed, Inc.*, 937 F.2d 380, 383 (7th Cir. 1991); *Stanford v. Humphrey*, No. 88-3997, 1990 WL 4659, *1 (9th Cir. Jan. 25, 1990) (unpub.); *Hunt v. Robinson*, 852 F.2d 786, 787-88 (4th Cir. 1988); and *Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187, 194 (3d Cir. 1976).

Wharf argued that UIH had no standing to assert a claim under Section 10(b) because UIH did not "purchase" stock of Wharf Cable or any other "security". Wharf argued that UIH's alleged oral option was not a "contract to buy, purchase or otherwise acquire" the stock of Wharf Cable because it was unenforceable under the Statute of Frauds, U.C.C. § 8-319 (1977). Wharf argued that UIH's lack of standing to assert a claim under Section 10(b) deprived the District Court of subject matter jurisdiction under 28 U.S.C. § 1331. The Tenth Circuit held that UIH's oral option allegations constituted an "oral security" which was "purchased" by UIH, in conflict with this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

The Tenth Circuit also held that the Statute of Frauds, U.C.C. § 8-319, was inapplicable to UIH's oral option allegations in conflict with the decisions of the Seventh and Eleventh Circuits in *Kagan v. Edison Brothers Stores, Inc.*, 907 F.2d 690, 691 (7th Cir. 1990); and *Pelletier v. Stuart-James Co., Inc.*, 863 F.2d 1550, 1555-56 (11th Cir. 1989). In reaching that conclusion, the Tenth Circuit ruled that: (1) UIH's oral option allegation, itself, was a ***security*** for purposes of the securities laws; (2) UIH's alleged oral option was ***not a security*** for purposes of the Statute of Frauds (U.C.C. § 8-319); (3) the Statute of Frauds barring oral agreements for the

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District Court's subject matter jurisdiction turned on plaintiffs' Section 10(b) allegation and 28 U.S.C. § 1331.

purchase of securities did not apply to oral options for the purchase of securities; and (4) the District Court's boilerplate contract consideration instruction was logically equivalent to a statute of frauds/partial performance instruction. (210 F.3d at 1225-26; P. App. B-24-25.)

Wharf argued that the District Court had no "arising under" jurisdiction under 28 U.S.C. § 1331 because Hong Kong law, not the federal securities laws, applied to the parties' relations, for the following reasons: (1) five of the six parties, including one of the plaintiffs, were resident in Hong Kong; (2) Wharf Cable was to operate in Hong Kong; (3) virtually all of the negotiations were in Hong Kong; (4) any services to be rendered by UIH pursuant to the stock purchase agreement being negotiated were to be rendered in Hong Kong; and (5) every document which addressed the choice of law issue and the admissions of several UIH officers proved that all parties had intended to apply Hong Kong law.

The Tenth Circuit rejected Wharf's position, arguing that: (1) no choice-of-law decision need be made at all because Wharf had allegedly failed to show that there was any material substantive difference between the securities laws of Hong Kong and those of United States, even though the District Court's "arising under" jurisdiction under 28 U.S.C. § 1331, depended upon the choice-of-law question (210 F.3d at 1222-23; P. App. B-18-21); and (2) Wharf had failed to prove that the parties' choice of Hong Kong law was set forth in an enforceable ***written*** contract (*id.*), even though the court's newly invented "requirement" could not be reasonably applied to a case where plaintiffs' entire claim was based on an alleged ***oral agreement***.

Wharf sought dismissal of all of UIH's state claims on the ground that UIH's allegations failed to state a cause of action under Section 10(b) or Rule 10b-5 and failed to state any cause of action arising under the laws of the United States pursuant to 28 U.S.C. § 1331. Wharf argued that since UIH's lack of

standing as a "purchaser" of "securities" and the absence of "arising under" jurisdiction was determinable on the face of the complaint on a motion under Fed. R. Civ. P. 12(b)(1) or 12(b)(6), the District Court should not have asserted supplemental jurisdiction over the state-law claims. Since the failure of UIH's Section 10(b) claim was obvious from the outset, the District Court should have dismissed all claims over which it might have had original jurisdiction because state-law claims substantially predominated, and these state-law claims involved issues of state law which were both novel and complex. *See* 28 U.S.C. § 1367(c). The Tenth Circuit held that UIH had stated a valid Section 10(b) claim, that the District Court had jurisdiction under 28 U.S.C. § 1331 and that the assertion of supplemental jurisdiction under 28 U.S.C. § 1367 was proper. (210 F.3d at 1219-21; P. App. B-12-18.)

Wharf sought dismissal of all of UIH's state and federal claims because the Statute of Frauds, U.C.C. § 8-319, made oral agreements to purchase securities, including UIH's alleged oral option, unenforceable and the absence of an enforceable right to purchase securities defeated UIH's state tort claims, as well as its contract claims. *See* pp. 33-35, *infra*. The Tenth Circuit offered two arguments for rejecting Wharf's position. *First*, the court erroneously ruled that the Statute of Frauds making oral contracts for the purchase of securities unenforceable did not apply because the oral option alleged by UIH was not a "security" within the Statute of Frauds. (210 F.3d at 1225; P. App. B-23-24.) By mistakenly applying the statutory term "security" to UIH's alleged oral option, rather than to the common stock of Wharf Cable which UIH alleged the oral right to purchase (and which clearly was a "security"), the Tenth Circuit rendered U.C.C. § 8-319 inapplicable to the only class of alleged agreements it was intended to bar, *i.e.*, oral agreements, such as UIH's oral option, to purchase securities. *Second*, the Tenth Circuit proceeded to excuse the District

Court's failure to instruct the jury on the Statute of Frauds[6] (210 F.3d at 1225-26; P. App. B-24-25), ruling that the court's instruction on contract consideration was sufficient, even though there is no rational basis for any conclusion that the consideration instruction subsumed the elements of a Statute of Frauds/partial performance instruction.

Wharf argued that the economic loss doctrine, which has been accepted by the Colorado courts, bars any tort claim in which a plaintiff seeks damages for economic loss based on a claim that the defendant fraudulently misrepresented its intention to perform a contractual obligation. *See, e.g., Jardel Enters. v. Triconsultants, Inc.*, 770 P.2d 1301, 1303 (Colo. Ct. App. 1988). The purpose of the economic loss doctrine is to enable parties engaged in commercial negotiations to contractually determine their exposure to legal claims for economic loss. The economic loss doctrine bars any tort claim where plaintiff has suffered only economic loss and alleges a tort which consists of defendant's refusal to perform a contractual obligation. Virtually every state court that has considered the issue has applied the economic loss doctrine to claims of intentional tort as well as negligence.

The Tenth Circuit held that the economic loss doctrine does not apply to intentional torts, in conflict with the Sixth, Seventh, Eighth and Eleventh Circuits.[7] (210 F.3d at 1226-27;

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[6] Wharf's statute of frauds objection to plaintiffs' alleged oral option raised questions of fact which had to be submitted to a jury pursuant to binding precedent from the Colorado Supreme Court and the Tenth Circuit. *See Lobato v. Bleidt*, Nos. 94-1264, 94-1275, 1995 WL 307609, *1 (10th Cir. May 11, 1995) (unpub.) ("whether part performance of an oral contract is substantial enough to take the contract out of the statute of frauds is . . . a factual question"); *Nelson v. Elway*, 908 P.2d 102, 108-09 (Colo. 1995) (en banc).

[7] While these Circuits considered these issues as they arose under the laws of other states, their decisions were in all but one case not controlled by any state appellate decision. The Tenth Circuit's assertion that Wharf engaged in any tortious conduct other than its allegedly fraudulent refusal

P. App. B-25-28.) *See Dinsmore Instrument Co. v. Bombardier, Inc.*, 199 F.3d 318, 320 (6th Cir. 1999); *AKA Distrib. Co. v. Whirlpool Corp.*, 137 F.3d 1083, 1086-87 (8th Cir. 1998); *Cooper Power Sys., Inc. v. Union Carbide Chems. & Plastics Co., Inc.*, 123 F.3d 675, 680-82 (7th Cir. 1997); *Hoseline, Inc. v. U.S.A. Diversified Prods., Inc.*, 40 F.3d 1198, 1199-1200 (11th Cir. 1994).

Wharf sought reversal of the District Court judgment because the entire documentary history of the transaction conclusively proved that Wharf and UIH both understood that the process of negotiation would proceed from an expressly nonbinding letter of intent to a formal, written stock purchase agreement which would become binding only upon approval by the parties' boards of directors and formal execution, neither of which events ever occurred. The Tenth Circuit ignored the conclusive documentary record of the parties' negotiations, in conflict with decisions of the Second Circuit and an earlier decision of the Tenth Circuit. *See Winston v. Mediafare Entm't Corp.*, 777 F.2d 78, 80-81 (2d Cir. 1986); *Reprosystem, B.V. v. SCM Corp.*, 727 F.2d 257, 261-63 (2d Cir. 1984); *Aircraft Sales of California, Inc. v. Insured Aircraft Title Serv., Inc.*, No. 90-6125, 1991 WL 274101 (10th Cir. Dec. 18, 1991) (unpub.).

Wharf sought vacatur of the compensatory damages judgment because UIH offered no evidence of the value of UIH's alleged option to acquire 10% of the stock of Wharf Cable for $50,000,000+/-. Instead, UIH's expert offered only evidence of the value of a 10% stock interest in Wharf Cable, which he estimated to be $67,000,000. (P. App. X; AE-2; AF-3-4.) The only relevant economic loss posited by plaintiffs was less than $1,000,000 in alleged reliance expenditures. (P. App. AY-1; J. App. F-2.)

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to permit UIH to exercise its alleged oral option was without citation or factual support. (210 F.3d at 1226-27; P. App. B-26-27.)

UIH brazenly misrepresented its expert's testimony to be a valuation of UIH's alleged option even though that option was worth some $50,000,000 less because UIH was obligated to pay an exercise price of $50,000,000 to buy its 10% stock interest. (P. App. AI-3-4.) The jury was deceived by UIH's misrepresentation and awarded "compensatory" damages of $67,000,000. The jury compounded this error by awarding punitive damages of $58,500,000. Because punitive damages cannot exceed compensatory damages under Colorado law, UIH's successful misrepresentation caused an error in excess of $100,000,000 in the judgment below. *See* Colo. Rev. Stat. § 13-21-102(1)(a).

The Tenth Circuit affirmed the District Court's award despite this egregious $100,000,000 error without any critical analysis of UIH's damage claims. The court did so because it found that UIH's expert had "considered" capital costs in valuing 10% of the stock of Wharf Cable. (210 F.3d at 1229; P. App. B-39.) In fact, plaintiffs' expert performed a conventional discounted cash flow ("DCF") analysis of the value of the stock of Wharf Cable. (P. App. X-6-9.) In performing DCF valuations of stock interests, all costs — current and capital — are deducted from all revenues. The fact that plaintiffs' expert considered capital costs, therefore, does not transform his valuation of a 10% ***stock interest*** into a valuation of an ***option*** to buy that 10% stock interest for $50,000,000.

Wharf sought appellate relief from the District Court's award of $58,500,000 in punitive damages because the only relevant evidence advanced by plaintiffs to prove any economic loss sustained as a result of defendants' breach of the alleged option were less than $1,000,000 in alleged reliance expenditures. Punitive damages in this case were, therefore, 65 times plaintiffs' only proven compensatory damages. Having refused to critically examine the evidence underlying the jury's $67,000,000 compensatory damage award, the Tenth

Circuit also affirmed the award of $58,500,000 in punitive damages. (210 F.3d at 1231-33; P. App. B-35-39.)

SUMMARY OF ARGUMENT

UIH's sole claim is that Wharf failed to perform an alleged oral option to sell UIH 10% of Wharf Cable for $50,000,000 — an act which UIH claims constituted a fraudulent promissory representation. UIH's claim does not state a cause of action cognizable under Section 10(b) of the Securities and Exchange Act of 1934 or SEC Rule 10b-5.

Since this Court's decisions in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) and *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), the Circuit Courts have consistently ruled that disputes over the ownership of securities, such as UIH's claim that Wharf misrepresented its intention to sell UIH the stock of Wharf Cable, do not state cognizable violations of Section 10(b). Cases alleging misrepresentations going to the value of a security purchase state Section 10(b) violations. Cases asserting rights to purchase stock, or complaining in contract or tort of the deprivation of such rights, have historically been resolved as matters of state law. This Court should not, at this late date, expand the cause of action judicially implied under Section 10(b) to cover such disputes.

In the *Blue Chip Stamps* case, this Court required that to have standing to assert a claim under Section 10(b), a plaintiff must be a purchaser of a security. UIH did not purchase the stock of Wharf Cable. UIH is not the purchaser of a security. UIH, therefore, does not have standing to assert a Section 10(b) claim. The Tenth Circuit's attempt to avoid the limitations of *Blue Chip Stamps* by judicially fashioning an "oral security" out of UIH's oral option allegation should be rejected.

UIH's lack of standing to assert a Section 10(b) claim was obvious from outset of this case, which should have been dismissed on a motion pursuant to Fed. R. Civ. P. 12(b)(1) or

12(b)(6). Under the criteria established in *United Mine Workers of America v. Gibbs*, 383 U.S. 715 (1966), the District Court should not have decided the state-law claims. The federal claim was dismissible at the outset of the litigation. The state-law claims substantially predominated; indeed, the only potentially viable claims were state-law claims. Those claims raised novel and complex issues of state law. *See* 28 U.S.C. § 1367(c).

ARGUMENT

I. THIS COURT SHOULD NOT EXPAND THE PRIVATE CAUSE OF ACTION JUDICIALLY IMPLIED UNDER THE SECURITIES AND EXCHANGE ACT OF 1934 TO COVER DISPUTES OVER THE OWNERSHIP OF SECURITIES WHICH HAVE HISTORICALLY BEEN GOVERNED BY STATE LAW.

The issue to be decided is whether the private cause of action judicially implied under Section 10(b) of the Securities and Exchange Act of 1934 ("Section 10(b)"), 15 U.S.C. 78j(b), and SEC Rule 10b-5 ("Rule 10b-5 "), 17 C.F.R. § 240.10b-5, should be expanded to apply to disputes over the ownership of securities, in this case taking the form of alleged misrepresentations of a party's intention to sell securities. Disputes concerning a party's obligation to sell securities have until now been governed by state law. *See* cases cited at pp. 31-32, *infra*. Section 10(b) cases normally involve claims that the defendant has made a financial or other misrepresentation affecting the value of a security purchase; not claims that a defendant has wrongfully refused to sell securities to a plaintiff.

UIH claims that a representative of Wharf orally agreed to give Wharf an option to purchase 10% of the stock of Wharf Cable during a conversation with UIH representatives on October 8, 1992. UIH claims that Wharf, in fact, did not intend to sell UIH that stock interest and that in promising to sell that

stock, Wharf misrepresented its intention to sell securities to UIH. UIH did not claim that Wharf made any misrepresentations concerning the financial condition of Wharf Cable or any other fact affecting the value to UIH of a purchase of the stock of Wharf Cable. UIH's claim is simply that Wharf misrepresented its intention to sell UIH 10% of the stock of Wharf Cable during that October 8, 1992 conversation.

The Wharf officer involved in that conversation has consistently denied that any such promise was made. The alleged promise was never reduced to writing or even referred to in any contemporaneous document. There was no evidence that any Wharf representative ever repeated or acknowledged the alleged oral option agreement at any time after the October 8, 1992 conversation. UIH never exercised the alleged oral option, purchased any stock or any other security, or invested any funds in Wharf Cable.

This case thus raises the issue of whether UIH had standing to assert a Section 10(b) claim in light of this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). To have standing, UIH must allege and prove that it purchased securities because Section 10(b) requires that any actionable fraud be "in connection with the purchase or sale" of a "security". UIH did not purchase any security. UIH did not purchase the common stock of Wharf Cable. The Tenth Circuit's refashioning of UIH's oral option allegations into an "oral security" which was "purchased" is inconsistent with the rationale of *Blue Chip Stamps* and with the decisions of the Seventh and Eleventh Circuits, both of which rejected attempts to base Section 10(b) actions on oral undertakings. *See Kagan v. Edison Bros. Stores, Inc.*, 901 F.2d 690 (7th Cir. 1990); *Pelletier v. Stuart-James Co., Inc.*, 863 F.2d 1550 (11th Cir. 1989).

A. The Circuit Courts have consistently held that claims that a defendant misrepresented its intention to sell securities do not constitute violations of Section 10(b) or Rule 10b-5.

As shown below, the decision of the Tenth Circuit constitutes a major expansion of the private right of action judicially implied under Section 10(b) to cover disputes over the ownership of securities which have traditionally been governed by state contract law. All Circuit Courts which have decided the issue since this Court's decisions in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), and *Santa Fe Industries v. Green*, 430 U.S. 462 (1977), have held that Section 10(b) does not extend to allegations of fraud premised on claims that a defendant fraudulently promised to sell securities to a plaintiff. The Third, Fourth, Seventh and Ninth Circuits have all reached that conclusion. *See Gurwara v. LyphoMed, Inc.*, 937 F.2d 380 (7th Cir. 1991); *Stanford v. Humphrey*, No. 88-3997, 1990 WL 4659 (9th Cir. Jan. 25, 1990) (unpub.); *Hunt v. Robinson*, 852 F.2d 786 (4th Cir. 1988); *Tully v. Mott Supermarkets, Inc.*, 540 F.2d 187 (3d Cir. 1976).

Viewed in light of the development of Circuit Court precedent since this Court's decisions in *Santa Fe* and *Blue Chip Stamps*, the Tenth Circuit's decision represents a dramatic expansion of the private right of action implied under Section 10(b) to federalize areas traditionally governed by state law.

In the *Santa Fe* case, this Court rejected plaintiffs' attempts to extend the reach of Section 10(b) to govern breaches of fiduciary duty traditionally governed by state law. Plaintiffs, who were minority shareholders in a Santa Fe subsidiary, complained that they had received inadequate consideration for their shares, which were acquired by Santa Fe through a short-form merger of that subsidiary. Under applicable Delaware law, Santa Fe, as a parent corporation

owning more than 90% of the subsidiary's stock, was entitled to acquire the stock of minority shareholders through merger without their consent. Therefore, there could be no claim that any alleged misrepresentation made in the course of the short-form merger caused plaintiffs' alleged injury. Rather, plaintiffs claimed only that Santa Fe had breached its fiduciary duty by making an inadequate payment for their shares. *See Santa Fe,* 430 U.S. at 455-58.

This Court noted that since Congress had not provided for private causes of action under Section 10(b), the judiciary should be careful to avoid expanding reach of that judicially implied cause of action beyond the limits suggested by congressional policy:

> [A] private cause of action should not be implied where it is unnecessary to ensure the fulfillment of Congress' purpose in implementing a philosophy of full disclosure. . . .

430 U.S. at 477-78. The Court concluded that the congressional purpose of promoting full disclosure to purchasers of securities did not justify federalizing the law applicable to the fiduciary duties of corporate officers. In limiting the reach of the private cause of action under Section 10(b), the Court sought to avoid federal regulation of "corporate conduct traditionally left to state regulation". *Id.* at 478.

Since this Court's decisions in *Blue Chip Stamps* and *Santa Fe*, the Circuit Courts have consistently held that Section 10(b) does not apply to alleged misrepresentations of a party's intention to sell securities. The Circuit Courts have consistently distinguished between misrepresentations relating to the *value* of a security purchase or the consideration paid and misrepresentations of a party's *intention to sell* securities. Disputes over misrepresentations affecting the value of the security purchase are resolved under Section 10(b). Disputes

over a plaintiff's claim of right to purchase, or a defendant's obligation to sell, a security have been resolved under state law.

The Circuit Courts have decided whether to extend the private cause of action implied under Section 10(b) to cover plaintiffs' claims of right to purchase securities on four occasions since this Court's decisions in the *Blue Chip Stamps* and *Santa Fe* cases. In each case, they have declined to do so. In most cases, the Circuit Courts have taken the position that misrepresentations of this kind do not implicate the congressional policy of full disclosure because they do not relate to the value of the security being purchased or the price being paid by the investor. In some of the cases, the Circuit Courts have also justified the result on the ground that the alleged misrepresentation was not made "in connection with" the "purchase" of a "security", because in each of those four cases, as in this case, the plaintiffs sought damages resulting from defendants' *refusal* to sell securities to plaintiffs.

In *Gurwara v. LyphoMed, Inc.*, the Seventh Circuit affirmed dismissal of a claim that an employee had been wrongfully deprived of the right to exercise an option to purchase the common stock of his employer by the employer's misrepresentation. Relying on this Court's opinion in *Santa Fe*, the Seventh Circuit held that because "the misrepresentations did not go to the value of the stock at issue or the value of the consideration in return for it", expansion of the liability implied under Section 10(b) was not warranted because it would not serve the congressional purpose "to implement a policy of full disclosure". 937 F.2d at 382, 383.

In *Hunt v. Robinson*, the Fourth Circuit affirmed the District Court's dismissal of a complaint for lack of subject matter jurisdiction where plaintiff complained that defendants had fraudulently refused to convey stock which had been promised in connection with plaintiff's employment. The Fourth Circuit held that extending Section 10(b) could not be justified because plaintiff "has alleged no misrepresentation of

the value of the stock". 852 F.2d at 788. Relying on *Santa Fe*, the court found that such an expansion of Section 10(b) would not serve the goal of implementing a "philosophy of full disclosure". *Id.* The court went on to observe:

> That goal is not furthered by bringing within the ambit of § 10(b) claims amounting to breach of contract or common law fraud which have long been staples of state law.

Id.

Stanford v. Humphrey also involved a claim by an employee against his employer for fraudulently refusing to sell stock in satisfaction of the employer's obligations under an alleged stock option. Dismissing plaintiff's Section 10(b) claims, the Ninth Circuit held that: "the alleged fraud in this case is in no way related to the value of the security; it simply relates to the failure to transfer the security". 1990 WL 4659, at *1.

Tully v. Mott Supermarkets involved a claim by a class of shareholders that Section 10(b) had been violated by a corporation's refusal to sell stock to them in violation of rights claimed to have been granted by the corporation's charter. *Tully* was decided by the Third Circuit after this Court's decision in *Blue Chip Stamps* but before *Santa Fe*. The Third Circuit held that plaintiff lacked standing to assert a claim under Section 10(b) because plaintiff had not purchased a security. The Circuit Court vacated the District Court's merits judgment on plaintiffs' state and federal claims, holding that the court did not have subject matter jurisdiction. Relying on this Court's decision in *Blue Chip Stamps*, the Circuit Court held that:

> The allegations are based not on injuries suffered as a result of plaintiffs' actual stock purchase, but rather on injuries caused by Wakefern's refusal to sell to plaintiffs . . . . We do not believe such allegations are sufficient to confer standing on plaintiffs in the absence of

> a showing of fraud in connection with this purchase of securities.

540 F.2d at 194.

B. No Circuit Court has held that a defendant's misrepresentation of its intent to sell securities constitutes a violation of Section 10(b).

There has been *no* Circuit Court decision to the contrary since this Court decided the *Blue Chip Stamps* and *Santa Fe* cases. *None* of the cases relied upon by the Tenth Circuit below involved claims of alleged misrepresentations of defendant's intention to sell securities. While some of the cases have unusual fact patterns making comparison with the cases cited above difficult, none of them involved a holding that a defendant's alleged misrepresentation of its intention to sell securities constituted a violation of Section 10(b).

The most important of these cases is the Seventh Circuit's decision in *S.E.C. v. Jakubowski*, 150 F.3d 675 (7th Cir. 1998). That case involved misrepresentations made in the course of defendant's attempt to unlawfully divert profits from the purchase and sale of depositors' rights to subscribe for the stock of mutual savings institutions being issued in connection with their conversion to stock ownership. In doing so, defendants were violating regulations of the Office of Thrift Supervision ("OTS") designed to secure profits from such subscriptions to the depositors.

The Seventh Circuit affirmed the S.E.C.'s sanction of defendants for such conduct in an enforcement proceeding, even though defendant's misrepresentation related to his violation of OTS regulations, rather than to the value of the stock being purchased. Thus, *Jakubowski* did not involve a claim that defendants had misrepresented their intention to sell securities. Indeed, *Jakubowski* did not even involve the private right of action judicially implied under Section 10(b), since it dealt with an S.E.C. enforcement proceeding.

Moreover, Judge Easterbrook went to great lengths to demonstrate that the result in *Jakubowski* was consistent with the Seventh Circuit's earlier decision in the *Gurwara* case discussed above. Judge Easterbrook reaffirmed the validity of the *Gurwara* decision, observing that the result in that case could be justified on the alternate ground that there was no sale of securities, just as there has been no sale of the stock of Wharf Cable in this case:

> In both *Blue Chip Stamps* and *Gurwara* stock had a bargain element that eluded a potential purchaser because of a deceit, which fell outside Rule 10b-5 because there was no sale.

Jakubowski, 150 F.3d at 680. Judge Easterbrook's opinion is, therefore, a reaffirmation of the Seventh Circuit's position that alleged misrepresentations of a defendant's intention to sell securities do not constitute a violation of Section 10(b).

Angelastro v. Prudential-Bache Securities, Inc., 764 F.2d 939 (3d Cir. 1985), involved alleged misrepresentations of the terms and costs of purchasing stock on margin, which allegedly caused plaintiff to underestimate the cost and risk of purchasing securities on margin. Those misrepresentations were directly related to plaintiffs' costs in purchasing securities and so affected the price paid by plaintiff and, therefore, the value of the security purchase to the plaintiff. In reaching its decision, the Third Circuit reaffirmed its earlier decision in *Tully v. Mott Supermarkets*, that alleged misrepresentations related to a defendants' obligation to sell stock do not constitute violation of the private cause of action implied under Section 10(b).[8] *See Angelastro,* 764 F.2d at 943.

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[8] *Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615 (9th Cir. 1981), relied on by the *Angelastro* court, is distinguishable for precisely the same reasons as *Angelastro*. Cases such as *Marbury Management, Inc. v. Kohn*, 629 F.2d 705, 707 (2d Cir. 1980), and *Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811 (2d Cir. 1975), which involve misrepresentations of a broker's

In the course of reaching its decision, the Third Circuit also noted that certain market practices not involving misrepresentations, such as churning, have been held actionable under Section 10(b). *See id.* at 944. Section 10(b) makes it unlawful for any person "to use or employ . . . any manipulative or deceptive device . . ." The Securities and Exchange Act of 1934 was not directed at misrepresentations alone. The Act was also enacted to proscribe certain actions, other than misrepresentations, designed to manipulate market prices to defraud investors. As Justice White observed in *Santa Fe*:

> 'manipulation' is 'virtually a term of art when used in connection with the securities markets'. The term refers generally to practices, such as wash sales, matched orders or rigged prices, that are intended to mislead investors by artificially affecting market activity.

430 U.S. at 476 (citation omitted).

Certain federal courts have defined the concept of nonrepresentational manipulation to include churning. *See, e.g., Costello v. Oppenheimer & Co., Inc.*, 711 F.2d 1361, 1368 (7th Cir. 1983). Whether right or wrong, those decisions have no relevance to this case, which involves an alleged misrepresentation, not a "manipulative device", as that term of art is used in the securities laws. Nor are they relevant to UIH's claim that the private right of action judicially implied under Section 10(b) should be expanded to cover claims of right to purchase securities which have historically been governed by state law.

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past investment results, are best understood as forms of financial misrepresentations of financial performance or as misrepresentations which are directly related to the reliability of the broker's representations, including recommendations about the value of the securities he recommends.

Anixter v. Home-Stake Production Co., 77 F.3d 1215 (10th Cir. 1996), was a garden-variety Section 10(b) case involving numerous financial misrepresentations affecting the value of Home-Stake's securities and the liability of its auditors in relation to those financial misrepresentations. *Mills v. Polar Molecular Corp.*, 12 F.3d 1170 (2d Cir. 1993), affirmed dismissal of plaintiffs' Section 10(b) complaint under Fed. R. Civ. P. 12(b)(6) on the ground that plaintiff's breach of contract allegations were *insufficient* to support a claim of fraud. *Richardson v. MacArthur*, 451 F.2d 35 (10th Cir. 1971), was decided before this Court's decision in *Santa Fe* and *Blue Chip Stamps* and is, therefore, of no relevance to the contemporary discussion of judicially implied liabilities under Section 10(b).

To summarize, on each of the four occasions in which a Circuit Court has had to decide whether the implied private cause of action under Section 10(b) should be expanded to cover misrepresentations of a defendant's intention to sell securities, the court has declined to do so. That result was reached by the Third, Fourth, Seventh and Ninth Circuits in *Gurwara*, *Stanford*, *Hunt* and *Tully* over the period from 1976 to the present. The courts have declined to do so because the congressional purpose underlying Section 10(b), which is to proscribe misrepresentations relating to the value of a security purchase to the plaintiff and the nature and value of the consideration paid, does not justify such an expansion. To petitioner's knowledge, there is no Circuit Court case decided since the *Santa Fe* and *Blue Chip Stamps* decisions which has held the contrary. Certainly, none of the cases cited by the Tenth Circuit below do so. To the contrary, disputes over parties' claims of ownership or claims of rights to purchase securities have historically been resolved by the application of state contract law. *See, e.g., Montana Mining Properties, Inc. v. Asarco, Inc.*, 893 P.2d 325 (Mont. 1995) (analyzing entitlement to allegedly purchased stock according to contract law); *Weitz v. Smith*, 647 N.Y.S.2d 236 (N.Y. App. Div. 1996) (same); *Butterfield v. Metal Flow Corp.*, 462 N.W.2d 815

(Mich. Ct. App. 1990) (same). Wharf respectfully submits that there is no reason to expand the private right of action judicially implied under Section 10(b), at this late date, to federalize matters which have historically been governed by state law, particularly in light of developing modern standards relating to the judicial implication of substantive rights not defined by Congress.

II. THIS COURT'S DECISION IN *BLUE CHIP STAMPS* MANDATES DISMISSAL OF UIH'S CLAIM BECAUSE UIH DID NOT PLEAD OR PROVE THAT IT HAD PURCHASED SECURITIES.

In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), a group of retailers to whom stock in the Blue Chip Stamp Corporation was offered pursuant to reorganization, but who elected not to purchase shares, attempted to assert claims under Section 10(b) against the offerors who allegedly misrepresented Blue Chip's financial prospects to dissuade the offerees from purchasing. This Court held that they could not. The Court first noted that Congress had not provided for private suits under Section 10(b). *See* 421 U.S. at 729. The Court noted that federal courts had nevertheless permitted such lawsuits for 25 years before the Supreme Court confirmed their decisions. *See id.* at 730.

This Court proceeded to note that Section 10(b) proscribed the use of manipulative and deceptive devices "in connection with the purchase or sale of any security" and that the federal courts had long held that to have standing to assert a Section 10(b) claim, a plaintiff must plead and prove that it was a purchaser of securities. *See id.* at 730-31 (citing *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952)).

This Court adopted what had come to be known as the *Birnbaum* rule and required that in order to have standing to assert a Section 10(b) claim, a plaintiff must have purchased securities. *See Blue Chip Stamps,* 421 U.S. at 731. One of the principal reasons for this Court's adoption of the *Birnbaum* rule

was the need to protect persons against lawsuits which "turn largely on which oral version of a series of occurrences the jury may decide to credit . . . ." *Id.* at 742. Noting the extraordinary potential of Section 10(b) cases for vexatious litigation and extortionate settlements, the Court required that plaintiff plead and prove purchase of a security to secure standing to sue because such purchases "are generally matters which are verifiable by documentation and do not depend upon oral recollection . . . ." *Id.* The Court went on: "[T]he abolition of the *Birnbaum* rule would throw open to the trier of fact many rather hazy issues of historical fact the proof of which depended almost entirely on oral testimony". *Id.*

In a more recent decision, this Court relied on the policy concerns expressed in *Blue Chip Stamps* in holding that allegations of directors' disbelief of a corporation's published statements, standing alone, would not support a Section 10(b) claim. In doing so, the Court noted:

> The root of those concerns [in *Blue Chip Stamps*] was a plaintiff's capacity to manufacture claims of hypothetical action, unconstrained by independent evidence.

Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1092 (1991).

The Circuit Courts have repeatedly held that plaintiffs must, at the very least, have an enforceable contract to purchase a security in order to have standing to assert a Section 10(b) claim. Section 10(b) requires that a plaintiff allege and prove that an alleged misrepresentation occur "in connection with the purchase or sale" of a security. The Act states that "purchase" includes a "contract to buy, purchase or otherwise acquire" a security. 15 U.S.C. § 78c(a)(13). To have a "contract", the courts have held that a plaintiff must have an enforceable contract.

The Seventh Circuit faced the question of whether a plaintiff must allege and prove an enforceable contract for the

purchase of a security in *Kagan v. Edison Brothers Stores, Inc.*, 907 F.2d 690 (7th Cir. 1990). Judge Easterbrook there ruled that the District Court had properly dismissed an action brought under Section 10(b) where the plaintiff did not have a contract to purchase securities enforceable under the Statute of Frauds, U.C.C. § 8-319:

> *Blue Chip Stamps* stressed the substantial problems of proof and high risk of error entailed in litigating claims that fraud prevented a sale from occurring. Statutes of frauds likewise are concerned with problems of proof. It is easy to say that there was an oral agreement. Section 8-319 of the UCC increases certainty in commercial life by preventing the enforcement of oral agreements to purchase or sell securities. The statute of frauds would be a hollow doctrine if disappointed sellers could convert their contract claims into actions under Rule 10b-5. The principles animating § 8-319 and the doctrine of *Blue Chip Stamps* alike require a conclusion that an unenforceable oral agreement is not a "contract" to purchase or sell securities.

907 F.2d at 691.

The Eleventh Circuit reached the same result in *Pelletier v. Stuart-James Co., Inc.*, 863 F.2d 1550 (11th Cir. 1989). The plaintiff in that case alleged that defendant brokers had required that he purchase shares of Denpac Corp. in order to purchase shares of UMB. Plaintiff alleged that the broker then "fraudulently" refused to sell plaintiff the UMB shares. Plaintiff alleged violations of Section 10(b) and common law fraud. The Eleventh Circuit affirmed the District Court's dismissal of all claims.

Relying on this Court's decision in *Blue Chip Stamps* the Eleventh Circuit held:

> a person who alleges a violation of Rule 10b-5 must demonstrate that he is an actual purchaser or seller or that

> he was party to a legally enforceable contract to purchase or sell securities.
>
> * * *
>
> . . . one of appellant's theories of liability is based on a fraudulent refusal to perform a contract for the sale of 10,000 units.

863 F.2d at 1555. The court went on to dismiss plaintiff's complaint because he had alleged only an oral promise to convey the shares of UMB and Section 8-319 of the U.C.C. made his claim unenforceable:

> appellant's theory based on fraudulent refusal to perform a contract for the sale of 10,000 units of UMB securities must fail because the alleged agreement is unenforceable as a matter of law.

Id. The Eleventh Circuit went on to dismiss plaintiff's state-law fraud claims because "appellant has not suffered any legally recoverable damages . . . ." *Id.* at 1559.

To the same effect, see *Gregg v. U.S. Industries, Inc.*, 715 F.2d 1522, 1531 (11th Cir. 1983); *Caplan v. Roberts*, 506 F.2d 1039, 1041-42 (9th Cir. 1974) (per curiam); and *Cohen v. Pullman Co.*, 243 F.2d 725, 728 (5th Cir. 1957), all holding that the deprivation of an unenforceable contractual right does not constitute legally cognizable injury in a tort action.

None of the cases cited by the Tenth Circuit conflicts with the opinions of the Seventh and Eleventh Circuits in *Kagan* and *Pelletier*. *Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986), was a garden-variety Section 10(b) claim involving financial misrepresentations. *In re Phillips Petroleum Securities Litigation*, 881 F.2d 1236 (3d Cir. 1989), involved an alleged misrepresentation made in the course of a corporate takeover that had inflated the market price of the target's stock, which plaintiffs had purchased. *Threadgill v. Black*, 730 F.2d 810

(D.C. Cir. 1984), is a cryptic per curiam opinion which ruled only that a partially executed contract for the purchase of securities was a contract for the sale of securities under the Securities and Exchange Act of 1934, 15 U.S.C. § 78(a)(13). There was no mention of the Statute of Frauds. As the Seventh Circuit put the point in *Kagan*:

> We do not understand *Threadgill* to hold that an oral agreement that could not be enforced in any respect under § 8-319 of the U.C.C. is nonetheless a "sale" within the meaning of the securities laws.

907 F.2d at 691.

Richardson v. MacArthur, 451 F.2d 35 (10th Cir. 1971), was decided before *Blue Chip Stamps*. In sum, none of the cases relied on by the Tenth Circuit involved the question of whether a plaintiff who has neither purchased stock nor acquired an enforceable contract to purchase stock has standing to assert a Section 10(b) claim.

This Court's holding in *Blue Chip Stamps* mandates the dismissal of UIH's claims in this case. UIH never purchased the common stock of Wharf Cable. UIH, therefore, had no standing to assert a Section 10(b) claim because it was not a purchaser. UIH's alleged oral option is unenforceable under the Statute of Frauds, U.C.C. § 8-319, just as the alleged oral claims in *Kagan* and *Pelletier* were unenforceable. More importantly, recognizing UIH's oral option claim as a "contract to purchase" securities would conflict with the motivating rationale of the *Blue Chip Stamps* decision to prevent the assertion of Section 10(b) claims based on oral evidence of purchase.

The Tenth Circuit sought to sidestep the mandate of *Blue Chip Stamps* by refashioning UIH's oral option allegations into an "oral security". That enabled the court to argue that UIH had "purchased" the newly fashioned "oral security" to satisfy Section 10(b)'s requirement of a representation made "in

connection with the purchase or sale of a security". The Tenth Circuit apparently did not realize that it was creating a "security" out of the very oral evidence which *Blue Chip Stamps* deemed an inadequate evidentiary foundation for Section 10(b) claims. Recognition of the Tenth Circuit's newly invented "oral security" would severely undermine the policies articulated in *Blue Chip Stamps*.

The Tenth Circuit also put itself in conflict with the decisions of the Third, Fourth, Seventh, Ninth and Eleventh Circuits, in *Kagan*, *Pelletier*, *Stanford*, *Hunt*, and *Tully*, all of which involved alleged oral events which could as easily have been refashioned into "oral securities" purchased by plaintiffs. If Chief Justice Rehnquist's admonition in *Blue Chip Stamps* against encouraging Section 10(b) claims which "turn largely on which oral version of a series of occurrences the jury may decide to credit" is to be given any practical effect, the Tenth Circuit's refashioning of UIH's oral option allegation into an "oral security" must be rejected.

To buttress its argument, the Tenth Circuit went to extreme lengths to hold that UIH's oral option allegation satisfied the Statute of Frauds as embodied in U.C.C. § 8-319, the same statute which the Seventh and Eleventh Circuits found to bar Section 10(b) claims in *Kagan* and *Pelletier*. In doing so, the Tenth Circuit committed two clear errors.

First, the Tenth Circuit decided that the Statute of Frauds applicable to the purchase of securities (U.C.C. § 8-319) did not apply because the oral option alleged by UIH was not a "security", as defined by the statute, and the statute, therefore, did not apply to oral options to purchase securities. In doing so, the Tenth Circuit mistakenly applied the statute's "security" definition to the oral option alleged by UIH, rather than the common stock of Wharf Cable, which was plainly a "security" under the Statute of Frauds. The court consequently rendered U.C.C. § 8-319 inapplicable to the very class of agreements it

was intended to render unenforceable, *i.e.*, oral agreements, including options, to acquire corporate securities.

Second, the Tenth Circuit proceeded to excuse the District Court's failure to give a jury instruction relating to the Statute of Frauds and partial performance, as required by the Colorado Supreme Court and the prior precedents of the Tenth Circuit, by ruling that the District Court's boilerplate contract consideration instruction was sufficient. *See Lobato v. Bleidt*, Nos. 94-1264, 94-1275, 1995 WL 307609 (10th Cir. May 11, 1995) (unpub.); *Nelson v. Elway*, 908 P.2d 102 (Colo. 1995) (en banc). The findings required to avoid the Statute of Frauds are different from, and far more stringent than, those required to support a finding of contractual consideration. To avoid the Statute of Frauds, UIH would have had to prove that any alleged partial performance was: (1) substantial; (2) required by the oral contract and (3) fairly referable to no other theory besides that allegedly contained within the oral agreement. *Nelson v. Elway*, 908 P.2d at 108. There is no rational basis for the Tenth Circuit's assertion that the District Court's boilerplate contract consideration instruction, which asked only whether UIH had "promised any services", required the jury to make the factual determinations called for by the applicable Statute of Frauds instruction.

One of Wharf's principal defenses was that the efforts undertaken in alleged reliance by UIH were undertaken to persuade Wharf that UIH was an attractive potential investor and were, therefore, not uniquely referable to UIH's alleged oral option.

Indeed, under the Colorado Supreme Court's construction of U.C.C. § 8-319, UIH could not have satisfied its requirement. In *Nelson v. Elway*, *supra*, the Colorado Supreme Court, sitting en banc, ruled:

> We hold that when a defendant makes a conditional representation to plaintiff . . . any detrimental change of

> position on the part of the plaintiff prior to the occurrence of the condition is unreasonable as a matter of law.

908 P.2d at 102. UIH's very last MOU tendered to Wharf in November of 1993 contained a condition; namely, approval by Wharf's board of directors, which never occurred. *See* pp. 11-12, *supra*.

Had the Tenth Circuit applied the applicable rules of law to this case, UIH's entire case would have been dismissed. The Statute of Frauds, of course, barred UIH's oral contract claims. UIH's failure to allege an option to purchase securities enforceable under state law would have required dismissal of UIH's federal and state-law securities claims under this Court's opinion in *Blue Chip Stamps* and the Circuit Court opinions in *Kagan* and *Pelletier*. UIH's remaining state-law tort claims would have been dismissed because UIH possessed no interest, the alleged deprivation of which would constitute a legally cognizable tort injury. *See Pelletier*, *Gregg*, *Caplan* and *Cohen*, cited at pp. 34-35, *supra*.

To summarize, UIH has no standing to assert a Section 10(b) claim because UIH is not a purchaser of securities. UIH never purchased the stock of Wharf Cable. UIH's alleged oral option was unenforceable under U.C.C. § 8-319 and UIH's Section 10(b) claim is foreclosed by the reasoning of the Seventh and Eleventh Circuits in *Kagan* and *Pelletier*. The Tenth Circuit's attempt to refashion UIH's oral option allegations into an "oral security" is inconsistent with this Court's rejection of oral evidence as an acceptable evidentiary basis for the proof of the "purchase" of a "security", as explained in *Blue Chip Stamps*.

III. THIS COURT SHOULD VACATE THE JUDGMENT AS TO ALL CLAIMS.

If this Court decides that UIH's federal claims must be dismissed, the Court will necessarily have to decide the nature of its remand instruction. Petitioners respectfully suggest that

this Court should enter an order which goes beyond its customary formulation on remand because of the confusion currently prevailing in the lower courts as to the standards which control the exercise of federal judicial authority over pendent state claims. In cases where a federal court's authority depends on the court's "arising under" jurisdiction under 28 U.S.C. § 1331, some courts dismiss state claims whenever it is (or should be) apparent on a motion under Fed. R. Civ. P. 12(b)(1) or 12(b)(6) that the action should be dismissed. *See, e.g., Textile Productions, Inc. v. Mead Corp.*, 134 F.3d 1481, 1486 (Fed. Cir. 1998); *Gaff v. Federal Deposit Ins. Corp.*, 814 F.2d 311, 319 (6th Cir. 1987); *Lechtner v. Brownyard*, 679 F.2d 322, 327-28 (3d Cir. 1982); *Tully v. Mott Supermarkets*, 540 F.2d at 196. Other federal courts assert authority over state claims so long as plaintiffs' federal claims are not "frivolous on their face", plainly "insubstantial" or "foreclosed by prior decisions of this Court". *See, e.g., Oneida Indian Nation of New York v. County of Oneida*, 414 U.S. 661, 666 (1974); *Musson Theatrical, Inc. v. Federal Express Corp.*, 89 F.3d 1244, 1255 (6th Cir. 1996); *Huffman v. Hains*, 865 F.2d 920, 922 (7th Cir. 1989).

The difficulty with the latter standard is twofold. First, varied understandings of frivolity make consistent application of the standard difficult. Second, the vagueness of the standard encourages District Courts to assert their judicial authority to decide issues of state law which are, in the interest of federalism, better left to state courts.

Whatever standard is applied, this Court should vacate the judgment below as to all claims in this case and direct the Court of Appeals to remand the case to the District Court with an instruction to dismiss the entire case. It has been clear since this Court's decision in *Blue Chip Stamps* that to have ***standing*** to assert a claim under Section 10(b), a plaintiff must have purchased a security. "In *Blue Chip*, we applied the *Birnbaum* rule . . . which limited ***standing*** under Rule 10b-5 to purchasers or sellers of securities." *Piper v. Chris-Craft Indus., Inc.*, 430

U.S. 1, 43 n.31 (1977) (emphasis added); *see also Powers v. British Vita, P.L.C.*, 57 F.3d 176, 187 (2d Cir. 1995) (*Blue Chip Stamps* "held that only purchasers and sellers of securities have ***standing*** to assert a claim of securities fraud under Section 10(b)") (emphasis added); *Jacobson v. AEG Capital Corp.*, 50 F.3d 1493, 1498 (7th Cir. 1995) ("only traditional purchasers or sellers of securities have ***standing*** to bring a Section 10(b) claim") (emphasis added); *7547 Corp. v. Parker & Parsley Dev. Partners, L.P.*, 38 F.3d 211, 227 (5th Cir. 1994) ("in *Blue Chip Stamps*, the Court limited ***standing*** to sue under section 10(b) to actual purchasers and sellers") (emphasis added).

In this case, UIH did *not* purchase the common stock of Wharf Cable. UIH's claim is, therefore, "foreclosed by prior decisions of this Court", *i.e.*, this Court's decision in *Blue Chip Stamps*. The fact that the Tenth Circuit sought to circumvent the foreclosure of *Blue Chip Stamps* by transforming UIH's allegation of an oral option into an "oral security", purchased by UIH, is of no consequence. In doing so, the Tenth Circuit relied on oral evidence of the very kind that moved this Court to adopt the "purchaser" limitation in the first place and thereby plainly transgressed the limitations of *Blue Chip Stamps*. UIH's "oral security" claim was, therefore, plainly foreclosed by *Blue Chip Stamps*.

In *Tully v. Mott Supermarkets*, 540 F.2d 187, discussed above, the Third Circuit vacated the District Court's judgment on the merits on both plaintiffs' Section 10(b) claims and plaintiffs' pendent state-law claims. In that case, the District Court had entered judgment on the merits of plaintiffs' federal and state-law claims. Having found that plaintiffs had no standing as Section 10(b) claimants because they had not purchased a security, the Third Circuit vacated the state-law judgment, holding:

> The substantiality of the federal claim is ordinarily determined on the basis of the pleadings. If it appears that

> the federal claim is subject to dismissal under F. R. Civ. P. 12(b)(6) or could be disposed of on a motion for summary judgment under F. R. Civ. P. 56, then the court should ordinarily refrain from exercising jurisdiction in the absence of extraordinary circumstances. . . . Applying these principles to the instant case, we believe that the pendent state claims should have been dismissed together with the federal claims. Plaintiffs' lack of standing to sue under Rule 10b-5 was a threshold bar which precluded them from stating in their complaint a cognizable claim for relief under the federal securities laws.

540 F.2d at 196.

The Sixth Circuit reached the same result in the *Gaff* case, 814 F.2d 311. Observing that the district "court determined that Gaff only could have suffered personal injury as a result of a substantive violation of the securities laws if he had either purchased or sold stock", and noting that "Gaff had not alleged that he was a purchaser", the Circuit Court went on to rule:

> The three prerequisites for the exercise of pendent jurisdiction are (1) the federal claims must have substance sufficient to confer subject matter jurisdiction . . . . Since the first prerequisite is not met here, the district court should not have exercised pendent jurisdiction. . . . Accordingly, we conclude that it was error for the district court to have retained jurisdiction over the purported state claims for the purpose of dismissing them with prejudice.

814 F.2d at 314-15.

Other Circuit Courts have mandated the dismissal of pendent state claims without requiring that the dismissal of the federal claim be jurisdictional, relying upon this Court's opinion in *United Mine Workers v. Gibbs*, 383 U.S. 715 (1966) (since codified in 28 U.S.C. § 1367). *See, e.g., Seabrook v. Jacobson*, 153 F.3d 70 (2d Cir. 1998); *Doe v. Sundquist*, 106

F.3d 702 (6th Cir. 1997); *Musson Theatrical, Inc. v. Federal Express Corp.*, 89 F.3d 1244 (6th Cir. 1996).

In *United Mine Workers v. Gibbs*, this Court established two principal criteria indicating dismissal of state claims once a federal claim has been dismissed. *First*, the Court ruled that: "The question of power will ordinarily be resolved on the pleadings. . . . Certainly, if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well." 383 U.S. at 726, 728. *Second*, the Court ruled that: "[n]eedless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law." *Id.* at 726.

Both criteria mandate dismissal of the state claims in this case. As in the *Tully* and *Gaff* cases, it was obvious from the outset (or should have been) that UIH had no standing to assert a Section 10(b) claim. UIH had not purchased the stock of Wharf Cable and its "oral security" claim was barred by the rationale of *Blue Chip Stamps*. *See* 28 U.S.C. § 1367(c)(3).

The fact that the District Court had mistakenly proceeded with the action provided no reason to ignore the teaching of *Gibbs*. As the Third Circuit observed in *Tully*,

> Were we to sustain the district court's exercise of pendent jurisdiction merely because of the time already invested in litigating the state claims, we would be insulating from review a significant class of cases solely because of an error had been perpetuated through the trial process. The needless expenditure of time and energy occasioned . . . by the improper exercise of pendent jurisdiction would thus become the justification for allowing the incorrect ruling to stand.

540 F.2d at 196.

The Seventh Circuit reached the same conclusion in *Wellness Community (R)-National v. Wellness House*, 70 F.3d

46 (7th Cir. 1995), where the court required the dismissal of pendent state claims after dismissal of federal claims despite the expenditure of judicial resources in adjudicating the state claims. The Seventh Circuit noted that the preservation of judicial resources argument

> has the vice of the circular argument: it will always be tempting to bootstrap supplemental jurisdiction after a trial is over.

70 F.3d at 50.

The dismissal of the federal claims would have meant that UIH's state-law claims substantially predominated, *see* 28 U.S.C. § 1367(c)(2); indeed, UIH's only potentially viable claims were state-law claims.

The Circuit Courts have also required the dismissal of state-law claims where the District Court exercised pendent jurisdiction to resolve novel or complex issues of state law. In *Seabrook v. Jacobson*, 153 F.3d 70 (2d Cir. 1998), the Second Circuit vacated a state-law judgment entered after dismissal of the federal claim on grounds of comity where important and novel issues of state law relating to civil servants were involved. The court noted:

> Needless decisions of state law should be avoided both as a matter of comity and to promote justice between . . . the parties.

153 F.3d at 72 (quoting *Gibbs*, 383 U.S. at 723).

The Sixth Circuit reached the same conclusion in *Doe v. Sundquist*, 106 F.3d 702 (6th Cir. 1997), a case involving the disclosure of adoption records. After dismissing plaintiffs' federal claims, the Circuit Court ordered the dismissal of pendent state claims because they involved state-law issues better suited for state court resolution.

The comity considerations articulated by this Court in *Gibbs* mandate vacatur of the state-law judgments in this case.

See 28 U.S.C. § 1367(c)(1). The decision in this case rested on the erroneous decision of two very important state-law questions. *First*, the Tenth Circuit ruled that the economic loss doctrine should not apply to allegations of intentional tort even though the Sixth, Seventh, Eighth and Eleventh have reached the opposite conclusion. *See Dinsmore, AKA Distributing Co., Cooper Power Systems* and *Hoseline*, cited at p. 19, *supra*. *Second*, the Tenth Circuit decided that the Statute of Frauds (U.C.C. § 8-319) barring the enforcement of oral contracts for the purchase of securities, does not apply to oral options. Both of those decisions resolve important state-law issues and are, Wharf believes, plainly erroneous. These issues should have been decided by the courts of the state of Colorado.

Wharf respectfully submits that this Court should remand this case with instructions that the case be dismissed in its entirety remitting the state claims to be tried in state court.[9]

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[9] Alternately, Wharf requests that the Court order that the state-law questions regarding the economic loss doctrine and the Statute of Frauds be certified to the Supreme Court of Colorado pursuant to Colo. App. R. 21.1(a), which provides that:

> The Supreme Court may answer questions of law certified to it by the Supreme Court of the United States, a Court of Appeals of the United States, a United State District Court, or United States Court of Claims, when requested by the certifying court, if there is involved in any proceeding before it questions of law of this state which may be determinative of the cause then pending in the certifying court and as to which it appears to the certifying court there is no controlling precedent in the decisions of the Supreme Court.

In this case, certification is "particularly appropriate in view of the novelty of the [state-law] question and the great unsettlement" of Colorado law. *Lehman Bros. v. Schein*, 416 U.S. 386, 391 (1974); *see also Stephan v. Rocky Mountain Chocolate Factory, Inc.*, 129 F.3d 414, 418 (7th Cir. 1997) (certifying state-law question to Colorado Supreme Court "[i]n light of the conflicting authority and our uncertainty about the applicability" of lower state court decisions).

CONCLUSION

Wharf respectfully submits that this Court should reverse the decision of the Tenth Circuit and rule that UIH has failed to state a claim cognizable under Section 10(b) or Rule 10b-5 because:

(1) UIH is not a purchaser of a security and, therefore, lacks standing to assert a claim under Section 10(b) or Rule 10b-5; and

(2) UIH's claim that Wharf misrepresented its intention to sell securities to plaintiffs does not constitute a violation of Section 10(b) or Rule 10b-5.

Wharf further respectfully submits that this Court should vacate the District Court's judgment as to federal and state-law claims, remitting the state-law claims to be determined by the courts of the state of Colorado.

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